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Via Electronic Submission

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, D.C. 20554

Re: ***Notice of Ex Parte - Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,*** **WC Docket No. 04-313; CC Docket No. 01-338**

Dear Ms. Dortch:

On behalf of SBC Communications Inc. ("SBC"), I am writing to address the October 19, 2004 Reply Declaration of Michael Pelcovits and Chris Frentrup, submitted on an *ex parte* basis by the KDW Group on behalf of numerous CLECs.[1] The bulk of this declaration attempts to rebut the evidence in the record establishing that special access prices have declined in the wake of pricing flexibility. The declaration also contends that a transport-impairment test based on business lines per wire center, as a proxy for CLECs' ability to collocate fiber in those wire centers, understates impairment. Finally, the declaration contends that ILECs' purported control over special access gives them power to distort competition in the enterprise market. These claims – which are in all events unsupported by any factual evidence – are based on flawed characterizations of the evidence in the record, of the legal task before the Commission, and of the nature of competition in the enterprise market. They should be rejected out-of-hand.

Special Access Pricing Trends

The focus of the Pelcovits/Frentrup Declaration is special access pricing. ILEC special access, they claim, is priced too high to permit CLECs to compete in the enterprise market, and ILEC claims that special access prices have fallen in the wake of pricing flexibility "are false."[2] As an initial matter, these assertions do nothing to rebut the core fact on which SBC and other ILECs rely in this proceeding: that CLECs, large and small, *already* rely on special access *today* to provide service to the enterprise market. More than three-quarters of the 511,000 DS1 loops that SBC sells to CLECs are sold as special access not

[1] *See* Ex Parte Letter of Thomas Cohen, KDW Group, to Marlene H. Dortch, FCC (Oct. 19, 2004) (attaching, *inter alia*, Reply Declaration of Michael Pelcovits and Chris Frentrup ("Pelcovits/Frentrup Decl.")).

[2] *See id.* at 1.

UNEs. For DS3s, the numbers are even greater: 97% of the DS3 loops SBC provides to CLECs are sold as special access. And CLECs have used those loops, purchased as special access, to win far more customers than SBC has in the enterprise market. SBC accounts for just over 5% of the enterprise market,[3] whereas the CLECs collectively control more than half of the market, and they are the primary service provider for close to three-quarters of large corporate accounts.[4] Just two weeks ago, moreover, AT&T crowed that it was "maintaining share at the high end of the market."[5] Pelcovits and Frentrup purport to describe the purported harm that CLECs *would* incur if they were to rely on ILEC special access. But there is no need to speculate. CLECs are using special access, today, to compete successfully in the enterprise market. It follows that, regardless of the trends in special access pricing, efficient competitors are not impaired – or, to use AT&T's formulation, "precluded"[6] – from serving the enterprise market without UNE access to ILEC high-capacity facilities.

Quite apart from their complete failure even to acknowledge, much less dispute, the abundant evidence of CLEC use of special access, Pelcovits and Frentrup's analysis of special access pricing trends is wholly unpersuasive. For one thing, they provide no evidence of their own to suggest that special access prices are not constrained by competition, preferring instead to attempt to poke holes in the ILECs' evidence. The CLECs' bear the burden of establishing impairment here, and it is accordingly not enough for them simply to assert that the evidence *the ILECs* have provided is unpersuasive. Rather, they must come forward with evidence establishing that they are precluded from providing service without UNE access. Particularly in light of the abundant evidence of CLEC competition in the enterprise market, their failure to do so in this context is dispositive of their claims of impairment.

In any event, Pelcovits and Frentrup fail to cast any doubt on ILEC evidence of special access pricing trends. Indeed, their primary rebuttal to SBC's evidence does not even dispute the central point – *i.e.*, that, in the wake of pricing flexibility, SBC's special access prices have declined. Instead, Pelcovits and Frentrup state that these admitted price declines are consistent with "expected" (though unspecified) "productivity increases."[7] This misses the point entirely. If, as the CLECs claim, SBC faced little competition in the market for special access, it would presumably be able to increase its prices irrespective of any "productivity increases." The fact that it has not – but that, instead, it has lowered prices significantly in the years since the Commission ordered pricing flexibility – conclusively rebuts the CLECs' claims, while at the same time vindicating the Commission's own judgment that its pricing flexibility triggers would identify "the presence of facilities-based competition with significant sunk investment" sufficient to "make[] exclusionary pricing behavior . . . costly and highly unlikely to succeed."[8]

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[3] *See* Casto Decl. ¶¶ 12-13. *See also* letter from Brett A. Kissel, Associate Director Federal Regulatory, SBC to Marlene H. Dortch, Secretary, FCC, August 27, 2004, WC Docket 02-112 (defining and describing enterprise market from a marketing and sales perspective).

[4] *See* Fact Report at III-32-33.

[5] Final Transcript, AT&T Third Quarter Conference Call, at 6-7 (Oct. 21, 2004) (quoting Bill Hannigan, AT&T President) ("*AT&T 3Q Conf. Call Transcript*").

[6] *See* AT&T Comments at 10.

[7] Pelcovits/Frentrup Decl. ¶ 17.

[8] Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 14 FCC Rcd 14221, ¶¶ 69, 80 (1999) ("*Pricing Flexibility Order*"), *aff'd*, *WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001).

Pelcovits and Frentrup's additional challenges to SBC's evidence are equally unpersuasive. As an initial matter, they mischaracterize SBC's showing of DS1 price declines, asserting that it "does not include . . . the effect of the prices [SBC] charges in MSAs in which it has received pricing flexibility."[9] In fact, SBC's evidence *does* include the effect of tariffed prices in those MSAs; it excludes only pricing flexibility contracts that involve discounts, an exclusion that serves only to understate the degree to which SBC's special access prices have declined. Equally important, Pelcovits and Frentrup's comparison of DS1 special access prices between pricing flexibility and non-pricing flexibility areas is based solely on rack rates.[10] As SBC has explained, SBC has developed an array of discounted special access offerings in pricing flexibility areas that provide CLECs with deep discounts off tariffed rates.[11] This pattern of discounting tariffed rates to attract high-volume customers is what AT&T has done for years in long distance,[12] and it demonstrates as well as anything else the existence of competition in the special access market. Pelcovits and Frentrup's failure to take those discounts into account renders their analysis not only inaccurate, but misleading as well.

SBC's evidence of special access pricing trends is fully consistent, moreover, with the evidence Verizon has adduced, and Pelcovits and Frentrup's challenges to that evidence are likewise without merit. Thus, for example, Pelcovits and Frentrup contend that Verizon's calculation of special access prices since the Commission ordered pricing flexibility does not properly reflect "changes in the mix of services purchased" by CLECs.[13] Yet this claim is, nearly word-for-word, recycled from AT&T's comments in this very proceeding, and Verizon has already rebutted it. In particular, Verizon has explained that a so-called "changing mix of services cannot account for the dramatic price reductions carriers have received in recent years" and, more fundamentally, that "prices for DS1 circuits *alone* have declined during the pricing flexibility period."[14] Likewise, SBC has provided evidence demonstrating that prices for DS1s in particular have declined dramatically.[15] Thus, whatever "changes in the mix of services" CLECs have opted to purchase, the fact is that they are paying less for those services today than they were before pricing flexibility.

By the same token, if in fact some portion of the special access price reductions is driven by the CLECs' ability to design their networks more efficiently and thereby reduce special access mileage charges – as Pelcovits and Frentrup assert without support[16] – so much the better. Indeed, far from undercutting Verizon's showing of special access price declines as Pelcovits and Frentrup wrongly assert, the ability of CLECs to design their networks more efficiently only confirms the fact that CLECs are able to meet their high-capacity needs with special access, and that they are paying less every year to do so.

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[9] Pelcovits/Frentrup Decl. ¶ 19.

[10] *Id.* ¶ 17.

[11] *See, e.g.*, Casto Decl. ¶¶ 7-8.

[12] *See, e.g.*, P. Britt, *Are Low-Volume Callers Paying Too Much*?, Telephony Online (Jul. 14, 1997) (noting that, as of the late 1990s, "70% of the total long-distance minutes AT&T bills are charged at a discounted rate," with the bulk of those minutes "concentrated among high-volume callers").

[13] Pelcovits/Frentrup Decl. ¶ 10; *compare* AT&T Comments at 107.

[14] *See* Verizon Reply Comments at 90 (citing Taylor Reply Decl. ¶¶ 17-23; Verses/Lataille/Jordan/Reney Decl. ¶ 61).

[15] *See, e.g.*, Casto Reply Decl. ¶ 63.

[16] Pelcovits/Frentrup Decl. ¶ 12.

Next, after pages spent claiming incorrectly that ILEC special access prices are not in fact declining (or at least not as fast as the CLECs would like), Pelcovits and Frentrup switch gears and claim instead that those prices are *already* too low. In particular, they complain that SBC's MVP plan provides wholesale discounts that are difficult for competitors to match, and that these plans accordingly operate to foreclose competing carriers from the special access market.[17]

As an initial matter, however, this claim is impossible to square with the facts on the ground. As noted above, and as explained in detail in SBC's reply comments, SBC faces a host of competitors in the special access market.[18] Even if Pelcovits and Frentrup's basic allegation here were true – *i.e.*, that SBC designed its MVP plan in order to "'lock up' the demand" of special access customers – the evidence makes clear that it has been woefully unsuccessful in accomplishing that aim. More to the point, Pelcovits and Frentrup's allegation is decidedly untrue. As SBC has repeatedly explained – and as the CLECs continue to ignore – MVP does *not* require customers to commit to buy a specific amount (much less all) of their total special access purchases from SBC. Rather, MVP requires only that, in order to obtain the additional discounts available under that plan, carriers commit to take a specified proportion of the high-capacity services they buy from SBC *as special access and not as UNEs.*[19] Moreover, as SBC has also explained, one of its largest special access customers – and among the most ardent critics of MVP in this proceeding – has voluntarily *increased* the amount of special access it purchases under MVP, even as it has moved a huge amount of traffic from SBC special access to competitive facilities.[20] In view of this evidence, the unsupported allegation that SBC's special access discounts foreclose competitors from using alternative facilities cannot be taken seriously.

Nor is it the case that the Third Circuit's decision in *LePage's Inc. v. 3M* provides support for Pelcovits and Frentrup's undeveloped claim of "exclusionary conduct" in the pricing of special access.[21] The question at issue in *LePage's* was whether a plaintiff could ever, under *any* circumstances, "succeed in a [Sherman Act] § 2 monopolization case [without] show[ing] that the [defendant] sold its product below cost."[22] The court answered that question in the affirmative, and it further found that a jury could find a § 2 violation where the defendant – which "concede[d] it possesse[d] monopoly power" (and which, in the market for scotch tape – offered large bundled rebates to plaintiff's major customers across *six* diverse product lines (including, to name just a few, retail auto products and home improvement products) the express purpose and demonstrated effect of which was to prevent buyers from purchasing transparent tape from plaintiff.[23] Contrary to Pelcovits and Frentrup's conclusory assertion, SBC's special access pricing plans involve none of those factors – no monopoly power, no large bundled rebates across multiple unrelated product lines that were effectively available only to customers that ceased giving business to plaintiff, no aim of foreclosing competition, and, perhaps most importantly, no evidence whatsoever that SBC's special access offerings have had that effect. Thus *LePage's* is not on

[17] *Id.* ¶¶ 20-32.

[18] *See* SBC Reply Comments at 45-46 (citing Casto Reply Decl. ¶¶ 7-8).

[19] *See, e.g.*, Casto Decl. ¶ 22.

[20] *See* SBC Reply Comments at 48-49.

[21] *See* Pelcovits/Frentrup Decl. ¶¶ 28-31.

[22] 324 F.3d 141, 145 (3d Cir. 2003).

[23] *See id.* at 146, 154.

point. Indeed, the volume discounts that SBC offers are the types of discounts which the *LePage's* court expressly stated are "concededly legal" and, indeed, procompetitive.[24]

High-Capacity Transport Impairment Test

Pelcovits and Frentrup next take aim at BellSouth's impairment test – a test that, like SBC's proposed DS1 transport carve-out, is based on the number of business lines in given wire centers, which in turn correlates with offices in which CLECs have collocated fiber. According to Pelcovits and Frentrup, the fact that competitive carriers have collocated (or could collocate) at both ends of a transport route says nothing about whether there is competitive transport running between those wire centers, since, after all, there may be two separate CLECs that have collocated in the respective wire centers. And, again in their view, that fact is dispositive, because the Commission can find no impairment only where a transport route is *already* fully competitive.[25]

This critique fails on multiple levels. First, the task before the Commission is not to identify markets that are already fully competitive without UNE access to ILEC facilities. The Commission tried that tack in the *Triennial Review Order*, and the D.C. Circuit vacated it. As the court made clear, the Commission's approach, which Pelcovits and Frentrup adopt here as their own, unlawfully "ignore[d] facilities deployment along similar routes."[26] The court directed the Commission on remand to adopt "a sensible definition of the markets in which deployment occurs," thus permitting the Commission to consider "facilities deployment along similar routes when assessing impairment."[27] Furthermore, in undertaking that "sensible" approach, as opposed to the flawed one embodied in the *Triennial Review Order* and advocated by the CLECs here, the Commission must consider the presence of "competition on one route" when it "assess[es]" impairment on other routes.[28] Accordingly, the inquiry is not whether particular routes are *already* fully competitive – as Pelcovits and Frentrup would have it – but rather whether "competition is possible" without UNEs in a particular market.[29]

Apart from their misunderstanding of the task before the Commission, Pelcovits and Frentrup's critique of BellSouth's test is also contrary to the manner in which competitive carriers deploy their own fiber. CLECs do not, as Pelcovits and Frentrup appear to contend, deploy fiber on a point-to-point basis. Rather, when competing carriers enter a market, they deploy fiber rings that connect to all major traffic aggregation points within the relevant area (such as ILEC central offices, carrier POPs, carrier hotels, and data centers), and then deploy to additional points as potential demand warrants.[30] The fact that a single carrier has collocated fiber in a given wire center therefore provides all the evidence the Commission needs to conclude not only that the wire center in question is large enough to support fiber deployment, but also that wire centers with like characteristics are likewise large enough to support fiber deployment. BellSouth's test, like SBC's, therefore properly asks whether competitive carriers have generally

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[24] *See id.* at 154.

[25] *See* Pelcovits/Frentrup Decl. ¶¶ 33-43.

[26] *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 575 (D.C. Cir.) ("*USTA II*") *cert. denied*, *NARUC v. United States Telecom Ass'n*, Nos. 04-12, 04-15 & 04-18 (U.S. Oct. 12, 2004).

[27] *Id.* at 574, 575.

[28] *Id.* at 575.

[29] *Id.*

[30] *See* Fact Report at III-9 & Table 6.

collocated in wire centers of a given size, and it infers from the answer to that question where competitive carriers can be expected to do so in the future. Nothing in the Pelcovits/Frentrup Declaration calls that approach into question.

It is for this reason, moreover, that Pelcovits and Frentrup's regression analysis is beside the point. That analysis purports to show that in some large wire centers, CLECs have not yet deployed their own fiber. That may be so, but it says nothing about whether competition is impaired without UNE access to ILEC transport originating in those wire centers. Again, the question is whether competition is *possible* in a given market, not whether it is already fully developed. Where CLECs have shown that they are capable of deploying their own fiber – as they have in wire centers with at least 5,000 business lines – it follows that competition is not impaired without UNE access.

Supposed "Pricing Distortions" in the Enterprise Market

Finally, Pelcovits and Frentrup contend that, in the enterprise market, even if ILECs play a small role today, they will purportedly be able to play a dominant role in the future, by underpricing their retail prices and thereby discouraging CLECs from investing in new facilities.[31] As an initial matter, this claim must be viewed with a high degree of skepticism. It is low retail prices that competition is supposed to *encourage*, and, so long as those prices are not predatory – which, in view of the competition in the market, would be irrational[32] – any CLEC claim that ILEC prices are *too* low must be rejected out-of-hand. As then-Judge Breyer explained, "a practice is not 'anticompetitive' simply because it harms competitors. After all, almost all business activity, desirable and undesirable alike, seeks to advance a firm's fortunes at the expense of its competitors. Rather, a practice is 'anticompetitive' *only if it harms the competitive process*."[33] In any event, Pelcovits and Frentrup provide no evidence that ILECs actually are under-pricing CLECs in the market. What is more, they fail to account for the CLECs' numerous advantages in the enterprise market – advantages that the CLECs themselves claim will prevent the ILECs from making any serious inroads.[34] In view of these relative market positions, Pelcovits and

[31] *See* Pelcovits/Frentrup Decl. ¶¶ 44-48.

[32] *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 229 (1993) (rejecting predatory pricing claim where competition in the market rendered recoupment "highly unlikely").

[33] *Town of Concord v. Boston Edison Co.*, 915 F.2d 17, 21 (1st Cir. 1990) (emphasis added). It is settled, moreover, that even below-cost pricing is not "predatory" where it is necessary to meet competition. *See, e.g., D.E. Rogers Assocs., Inc. v. Gardner-Denver Co.*, 718 F.2d 1431, 1438 (6th Cir. 1983) ("'it is not anticompetitive for a company to reduce prices to meet lower prices already being charged by competitors'") (quoting *Richter Concrete Corp. v. Hilltop Concrete Corp.*, 691 F.2d 818, 826 (6th Cir. 1982)); *United States v. AMR Corp.*, 140 F. Supp. 2d 1141, 1204 (D. Kan. 2001), *aff'd on other grounds*, 335 F.3d 1109 (10th Cir. 2003).

[34] AT&T recently emphasized that it is "maintaining share at the high end of the market," that *80%* of its enterprise services are offered exclusively over its own facilities, and that it is "continu[ing] to build private [fiber] rings for [its] largest customers." *AT&T 3Q Conf. Call Transcript* at 6-7; *see also* R. Krause, *Bernard Faces New Round of Challenges*, Investor's Bus. Daily, July 21, 2003, at 3 (quoting then-President of AT&T Business Betsy Bernard) (in the enterprise space, the Bell companies "'don't have the assets, the networks, the services. It takes *decades* to build that capability.'"); W. Huyard, *MCI Exits Bankruptcy*, Technews.com (Apr. 21, 2004) (transcript of online discussion) ("[w]hen . . . going after . . . large domestic (US) business customers," MCI's "most serious competitor is AT&T," not the Bell companies).

Frentrup's theorizing about the ILECs' purported ability to forestall competition in the enterprise market is simply irrelevant.[35]

* * *

The evidence in the record makes clear that CLECs can and do compete using ILEC special access. Unable to counter that dispositive fact, Pelcovits and Frentrup simply ignore it, and they instead theorize about the possibility of exclusionary conduct at some point in the future. The Commission, however, does not have the luxury of ignoring the facts on the ground. As the D.C. Circuit has made clear, "competitors cannot generally be said to be impaired by having to purchase special access services from ILECs, rather than leasing the necessary facilities at UNE rates, where robust competition in the relevant markets belies any suggestion that the lack of unbundling makes entry uneconomic." In the enterprise market – where CLECs account for the vast majority of the market, and where they have attained that position relying on special access far more than they rely on UNEs – that is the end of the matter.

Yours truly,

Gary L. Phillips

cc: Michelle Carey
Thomas Navin
Russell Hanser
Jeremy Miller
Marcus Maher
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Carol Simpson
Tim Stelzig
Cathy Zima
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[35] Pelcovits and Frentrup also contend that, because special access purportedly makes up a lower percentage of wireless costs than it does of wireline costs, competition in wireless using special access is irrelevant to the question of impairment for wireline carriers. *See* Pelcovits/Frentrup Decl. ¶¶ 49-51. But this claim – which in all events wrongly assumes that CLECs typically purchase special access at rack rates – misses the point. The question is not whether wireless and wireline carriers are equally unimpaired without UNE access to high-capacity facilities. Rather, the question is whether *either* wireline *or* wireless carriers can establish impairment, where the evidence shows that both types of carriers successfully compete using special access. As SBC has shown throughout this proceeding, and as the D.C. Circuit has made clear, they cannot.